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Subordination, Non-Disturbance and Attornment Agreements in Commercial Leasing and Real Estate Finance

Drafting and Negotiating SNDA Agreements to Protect Lenders, Tenants and Landlords

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Strafford Webinar

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What are SNDAs?

Documents that contain:

- Subordination
- Non-Disturbance
- Attornment
- Other Provisions
 - Estoppel Certificate
 - Agreements

Who are the Parties to an SNDA?

- Usually, SNDAs are made by the Landlord, Tenant, and Lender
- Sometimes, only Lender and Tenant are the parties, and Landlord joins in to show its consent
- If the Lease is guaranteed, any Guarantor should consent to the SNDA

Who are the Parties to an SNDA?

- Tenant should insist that the Lender sign the SNDA

Subordination

- What is the priority of Lease vs. Mortgage?
- Basic Rule:
First in time is first in right
- May be modified by agreement of the parties
 - There may be a provision in the Lease stating the Lease will be subordinate to future mortgages
 - The parties may enter into an SNDA

Subordination

The Lender will want the Lease to be subordinate to Lender's mortgage or deed of trust

- including to any future advances
- Including to any modifications

Effects of Subordination

- Provisions of the senior instrument control
 - Casualty and use of insurance proceeds
 - Condemnation proceeds

Continuation of Lease after a Foreclosure Sale

- If lease is superior, a foreclosure sale does not affect the Lease -- except that Tenant has a new landlord
- If mortgage is superior, a foreclosure sale terminates the Lease -- but some states have provisions enabling Lender to designate which leases will survive a foreclosure sale
- Loan documents may permit Lender to make a subordination election (Lender wants to “pick and choose”)

Continuation of Lease after a Foreclosure Sale

- State law examples:
 - See Maryland Code, Real Property Article §7-105.6(c)
 - See *Dover Mobile Estates v. Fiber Form Prods.*, 220 Cal. App. 3d 1494 (1990), and *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freeman*, 65 Cal. App. 4th (1998).
See also *Vallely Inv. v. BancAmerica Commercial Corp.*, 88 Cal.App.4th 816 (2001) (discussing situations where lien foreclosure does not automatically terminate leases).

Continuation of Lease after a Foreclosure Sale

MD Real Property Article §7-105.6(c):

(1) If the required advertisement of sale so discloses, a foreclosure sale shall be made subject to one or more of the tenancies entered into subsequent to the recording of the mortgage or deed of trust or otherwise subordinated thereto.

(2) Any lease so continuing is unaffected by the sale, except the purchaser shall become the landlord, as of the date of the sale, on ratification of the sale.

- This is not the same in every state.

Non-Disturbance

- **Non-Disturbance** is the key provision for a tenant when the lease is subordinate to the mortgage
- Permits a lease to continue after a foreclosure sale even though the lease was subordinate to the mortgage that is foreclosed
- Sometimes called “Recognition”

Non-Disturbance (Continued)

- Often extends to a deed-in-lieu
 - but a deed-in-lieu would not terminate a lease
- May be premised on tenant's not being in default under lease or Tenant's never having been in default

Attornment

The last letter of SNDA is for **Attornment**

- The act of Tenant agreeing to become tenant of the holder of the remainder or reversionary estate
- “Attornment” has the same root as “attorney”
 - which means one who is appointed to act for another

Attornment (continued)

- In an SNDA, Tenant agrees to be bound by the terms of the Lease
 - to any person who acquires the remainder or reversion
 - including a purchaser at a foreclosure sale or other proceedings under the loan documents
 - may be Lender, an affiliate of Lender, or a third party

Attornment (continued)

- State law may provide that transferees of the reversion in leased property are entitled to the same rights and are subject to the same obligations as the original landlord
- See Maryland Code, Real Property Article, § 8-101
- See *Principal Mut. Life Ins. Co. v. Vars, Pave, McCord & Freeman* (CA)

Attornment (continued)

MD Real Property Article § 8-101 provides that a transferee of the reversion in leased property is entitled to the same rights and is subject to the same obligations as the original landlord.

Not all states have similar provisions.

Additional Provisions

Estoppel Certificate

- Identify the Lease, all amendments, and all collateral documents
- State the Commencement Date and the Termination Date of the Lease
- Acknowledge that Landlord does not have any remaining construction obligations
- State what security deposit has been posted

Additional Provisions (continued)

Estoppel Certificate (continued)

- Acknowledge that all conditions precedent to the commencement of the Lease have occurred
- Assert that Tenant is not in default under the Lease
- State that Landlord is not in default under the Lease
- State that Tenant has no claims against Landlord and no offsets under the Lease
- Represent that Tenant has not assigned, sublet, or encumbered the leasehold interest

Additional Provisions (continued)

Estoppel certificate (continued)

- State the amounts Tenant is paying and through what dates they have been paid:
 - for basic rent
 - for percentage rent
 - for CAM or other charges
 - for real property taxes

Additional Provisions (continued)

Estoppel certificate (continued)

- State whether Tenant has any option in the Lease:
 - to renew
 - to take additional space
 - to purchase
- State whether Tenant has exercised any of its options

Additional Provisions (continued)

Notices to Lender

- Provide that Lender is entitled to all of the notices to which Landlord is entitled
- Provide that Lender will have a stated time, the same time as landlord, or an additional time to cure defaults
- Provide that Lender will have the time to exercise its remedies against Landlord (as its borrower) and then the time to cure Landlord's defaults under the Lease
- Provide that the Lease will not be terminated for events that Lender cannot cure (e.g., Landlord's bankruptcy)

Additional Provisions (continued)

Use of the property

- Lender wants a certification by Tenant that it
 - has always used the property In accordance with the Lease
 - has not created any environmental issue

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (a) Lender (or other successor to Landlord) has no liability to Tenant for any act or omission of the original landlord

Additional Provisions (continued)

No liability for prior landlord's acts

- Possible compromise:
 - Tenant may forego ability to terminate the Lease
 - Tenant will agree to limit its remedies to the right to offset damages against rent
 - Perhaps the offset will be limited to ___% of base rent

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (b) Lender has no liability to return Tenant's security deposit except to the extent that Lender has actually received it

Additional Provisions (continued)

No liability to return security deposit Lender has not received

- Possible compromise:
 - Lender could hold the security deposit from the beginning
 - A third party could hold the security deposit
 - The security deposit could be in the form of a letter of credit or other credit enhancement

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (c) any offset or claim that Tenant may have against Landlord will not apply to Lender
 - This would put all of the risk of a defaulting landlord on Tenant, and many Tenants will find this objectionable

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (d) Lender (or other successor to landlord) is not bound for more than one month's rent paid in advance
 - This is a reasonable request.

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (e) Lender is not bound by any amendment to the Lease made without consent of Lender
 - (f) Lender is not bound by any assignment or sublease to the Lease made without consent of Lender
 - NOTE: Although asking a Tenant to agree not to amend the Lease without Lender's consent may be reasonable, asking Tenant to give up a right to assign or sublet is not.

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (g) Tenant will pay rent to Lender upon written notice from Lender (without confirmation from Landlord)

Additional Provisions (continued)

After the foreclosure sale

- Lender wants Tenant to agree:
 - (h) Lender will not be required to pay any tenant improvement allowance or be bound by any construction warranties made by Landlord
 - But tenant improvement allowances are essentially repaid by a component of the rent

Additional Provisions (continued)

Unpaid Tenant Improvement Allowance

- So in compromise:
 - the rent may be reduced if Tenant will have to pay for its improvements, or
 - Landlord may be required to post funds in escrow, or provide a guaranty, or include a right to offset in the Lease

Additional Provisions (continued)

Future agreements

- Lender wants Tenant to agree:
 - Tenant will execute estoppel certificates from time to time
 - Without Lender's consent
Tenant will not surrender, cancel, or terminate the Lease
-- except upon an uncured default of Landlord

Additional Provisions (continued)

Lender's "Clean up" of the Lease

Lender may want Tenant to

- waive options
- waive co-tenancy requirements
- release Lender from environmental requirements
- waive warranties made by Landlord

SNDAs for Different Interests in a Property

Other parties with various interests in the property, including:

- ground lessees and
- sublessees

also want similar rights and assurances – such as from the ground lessor and ground sublessor.

Who Needs an SNDA?

Lender

- wants its loan documents to control – but the Lease may already have been subordinated
- wants the “additional provisions”

Who Needs an SNDA?

(continued)

Tenant

- wants the assurance that if its landlord defaults under its loan, the Lease will continue unaffected (except that Tenant will have a new landlord)

Who Needs an SNDA?

(continued)

What Can a Tenant Do

- to get the beneficial portions of an SNDA
- without the burdensome ones
- and to minimize its expenses?

Who Needs an SNDA?

(continued)

What Can a Tenant Do?

- Prepare an SNDA and attach it to the Lease
- Hope that the Lender accepts it
- This may reduce legal fees
- Provide that the Tenant will not be joined in a foreclosure action (unless it is a necessary party)

Who Needs an SNDA?

(continued)

Landlord / Loan Borrower

- does not care about the SNDA
. . . the provisions of an SNDA become operative after Landlord has defaulted under its loan
- wants to get the SNDA signed quickly and without expenditure of too much money